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"Adversarial Trade" Proposal: More Talk Than Action

The "adversarial trade" proposal included in S 490 has received a large amount of attention since the introduction of the Senate omnibus trade bill on February 5. Labeled by some as the Senate's alternative to HR 3's mandatory trade surplus reduction provision (the "Gephardt amendment"), the Senate proposal is at first glance a tough response to the unfair trade practices of other countries. A careful examination, however, reveals that the provision is not a significant departure from current law.

Under S 490, the U.S. Trade Representative must identify those countries that the National Trade Estimate reports maintain trade barriers and also have adopted a "consistent pattern of barriers and market-distorting practices." (The National Trade Estimate is USTR's annual inventory of barriers to U.S. exports. See JEI Report No. 45B, December 12, 1986.) The president must then initiate negotiations to eliminate all distortions and report to Congress by the end of 1988 on his progress, listing any increases in U.S. exports to the

Financial Markets In Japan: A Look Backward And Forward

Japanese financial institutions and markets continue to boil over with activity. Slower economic growth, a stronger yen and progressive deregulation have resulted in reduced domestic demand for investment, large sums of idle cash and greater access to foreign financial markets. Just as Japanese firms have been actively expanding abroad, foreign competitors have been busy building a stronger presence in Japan. Not surprisingly, this flurry of activity has led to record trading volumes on several markets.

According to the daily Nihon Keizai Shimbun, the outstanding balance of short-term financial instruments jumped an estimated Y50 trillion ($322.6 billion at Y155=$1.00) in 1986 to Y130 trillion ($838.7 billion) at yearend. This broad category includes the call money and bill-discount interbank markets, which grew by some Y5 trillion ($32.3 billion) to Y24 trillion ($154.8 billion); foreign currency deposits, which doubled to Y20 trillion ($129 billion); large time deposits, which jumped four times to the same level; short-term government bonds, which rose to Y2 trillion ($12.9 billion); certificates of deposit, money market certificates, bonds with repurchase agreements (gensaki) and the Tokyo dollar call market.

The Tokyo International Banking Facility, or offshore market, has gotten off to a strong start. At the end of December, its first month of operation, deposits totaled Y11 trillion ($71 billion); a month later they came to approximately Y17 trillion ($109.7 billion). This led the Ministry of Finance to predict that the Tokyo IBF will pull abreast of the New York offshore facility (which had a closing 1986 volume of $260 billion or so) in two to three years. The new market is apparently attracting funds from around the globe. Southeast Asian investors have jumped at the new opportunities presented by the facility, as have Middle Eastern, Chinese and even Soviet banks. But more importantly, Japanese banks are using the market to reduce their vulnerability to fluctuations on the Tokyo dollar call market. Therefore, even though the Finance Ministry sought to insulate the domestic market from the international facility, dollar rates often move in tandem on the two.

Tokyo bond markets continue to show very strong growth. After making a huge jump in 1985 when volume rose from about Y800 trillion ($5.2 trillion) to Y2,130 trillion ($13.7 trillion), the cash market grew to Y2,650 trillion ($17.1 trillion), a gain of "only" 24.4 percent. Even greater strides were realized in the bond futures market, which opened in October 1985 and closed out that year with a volume of approximately Y200 trillion ($1.3 trillion). Institutional investors and non-financial corporations were extremely active hedging against fluctuations in the cash market. This pushed volume up to an estimated Y1,870 trillion ($12.1 trillion) -- on a par with activity at the Chicago Board of Trade, the world's largest bond futures market. An increase in the number of dealers authorized to handle central and local government bonds and government-guaranteed bonds from 87 to 136 also fueled the market's growth.

The Tokyo Stock Exchange enjoyed a bull market, with the Nikkei Index up nearly 50 percent by the end of the year. Recently the market has been gripped by public-corporation fever. Shares of Nippon Telegraph and Telephone Corp. were listed for the first time on February 9 and immediately proceeded to break records. Pushing past the Y200,000 ($1,290) daily stop limit, the issue rose from an initial Y1.2 million ($7,742) per share to Y1.86 million ($12,000) by

February 12 -- translating into a record-setting prospective price/earnings ratio of 162 and an historic p/e ratio of 206. Government-held shares of Japan Air Lines Co., Ltd. and the privatization of Japanese National Railways are expected to keep the market boiling. Foreign companies are also rushing to list on the TSE; 52 were traded on the Tokyo floor at the end of 1986, well above the 21 listed at the end of 1985. The leadership of the TSE has announced that it is considering expanding its membership by the spring of 1988 from the present 93 to around 100. More foreign firms can be expected to join the six admitted in November 1985.

Not to be left out, the over-the-counter market also enjoyed strong growth in 1986. A record 22 new firms decided to list over the counter, taking advantage of the easier criteria. (A Y10-a-share profit is required to list on any of Japan's stock exchanges.) The 1986 OTC volume was estimated to be 2.2 times that of the previous year, with 260 million shares worth Y2 trillion ($12.9 billion) traded. Several of Japan's fast-growing service companies, including Toa Domestic Airlines Co., Ltd. and Asahi Business Consulting Co., Ltd., are considering listing over the counter, presaging continued market growth.

Just as Japan's securities companies have made a big splash on New York and European markets, American firms are starting to flex their muscle in Tokyo. Salomon Brothers Asia Ltd. announced that the Ministry of Finance approved a capital infusion of $300 million, bringing its total capital up to about Y50 billion ($322.6 million), close to the smallest of the top four Japanese dealers, Yamaichi Securities Co., Ltd. Salomon has made a concerted effort to become a major player in the market for Japanese government bonds. It actually won the largest share (Y45 billion or $290.3 million) of a February 3 offering of Y110.9 billion ($715.5 million) worth of two-year bonds, with Nomura Securities Co., Ltd. winning Y30 billion ($193.5 million). According to reports, most foreign securities firms are doing well in Japan (see Table).

After-Tax Profits of Foreign Securities Companies in Japan

(in millions of yen for the year ending in September)

	1985	1986
Salomon Brothers Asia	Y269	Y1,698
Jardine Fleming Securities	329	1,395
Merrill Lynch Japan	428	552
Bache Securities (Japan)	-76	493
Morgan Stanley International	-61	404
W.I. Carr (Overseas)	102	378
First Boston (Asia)	-64	345
S.G. Warburg Securities (Japan)	6	167
Vickers da Costa	82	165
Kidder, Peabody	33	67
Smith Barney, Harris Upham	7	38
Goldman Sachs (Japan)	4	-71

Source: Japan Bond Research Institute

In the meantime, Tokyo continues to make changes, many due to its tax reform program:

- The securities transaction tax on convertible bonds will be raised from 0.045 percent to 0.26 percent of the sale price effective April 1, 1987.

- A tax of 0.002 percent will be levied on transactions in the government bond futures market.

- Taxes of undetermined size will be levied on transactions in the offshore, dollar call and uncollateralized call markets. Interest paid on certificates of deposit will remain lightly taxed.

- MOF also wants to tighten up on capital gains taxes by lowering the floor for institutional traders. Gains will be taxed after 30 transactions of 120,000 shares or more, rather than after 50 transactions of 200,000 shares.

- MOF plans to ease the criteria that foreign firms must meet to list on Japan's OTC market. The ministry hopes that this will push the TSE to ease its listing requirements.

- The Finance Ministry will raise the asset requirements for investment advisory firms. This group of about 50 foreign and domestic companies offers fund management services to individuals and corporations. MOF has received 191 applications for management licenses to be issued in May: 77 from independent firms, 26 from companies with ties to securities houses, 43 from firms linked to banks, 20 from affiliates of insurance companies and 25 from foreign companies. The ministry is requiring that firms maintain Y100 million ($645,161) in assets by the third year of operation and have Y20 billion ($129 million) in entrusted assets in order to qualify for a license. If the foreign parent has more than Y100 billion ($645.2 million) in entrusted assets, a foreign subsidiary may waive the Y20 billion requirement.

- MOF will permit commercial banks to issue domestic convertible bonds within a few months as part of its financial liberalization plan. Due to opposition by long-term credit banks, MOF will only allow the smaller regional banks to float such bonds. The larger city banks, which are expanding abroad, are pressing for similar treatment. Since the issuance of convertible bonds is tantamount to a long-term loan, MOF has hesitated but may relent by the end of this year.

- Finally, the Osaka Stock Exchange is preparing to open Japan's first stock futures market on April 6. According to a Nihon Keizai Shimbun survey, there is widespread interest in the new market. Interestingly, 85 percent of the respondents said that they would use the market as a hedge against price fluctuations of their own stock or in their portfolios; 50 percent were interested in using the market for speculation; and 42 percent said they would act to arbitrage prices between the future and spot markets. This represents an entirely new market for Japanese firms, and many are busy preparing for the opening.

Clearly Japan's financial markets have taken a quantum leap. MOF continues to deregulate incrementally, but is not reluctant to impose new rules if a market proves to be unruly, as in the consumer finance area.

Nevertheless, these fast-growing markets offer new opportunities for domestic and foreign firms alike.

Jon Choy

Defense Group Releases Semiconductor Study

Calling integrated circuits the "industrial rice" of modern industry, a special task force of the Defense Science Board urged the establishment of a government-funded effort in cooperation with the private sector to preserve the U.S. manufacturing base in the face of growing competition from Japan. In a study released February 12, the task force said that in every area of semiconductor production except one -- linear (analog) nonsilicon products -- the United States trailed or is losing its technological edge to Japan. In response, it called for a comprehensive strategy to reverse the trends that threaten to destroy this country's semiconductor production base and, by implication, its ability to rely on technological superiority to defend the nation. Some members went so far as to urge a strict "buy America" or quota policy to insure against U.S. dependence on foreign sources for integrated circuits.

While the report concluded that the United States relies on foreign supplies for approximately 10 percent of its total semiconductor needs, the DSB members are concerned that declining market share will constrain the ability of American producers to fund the basic research and development necessary to introduce new products. The report blames differences in industrial practices and structures between the United States and Japan for these performance disparities. In the area of industrial structure, for example, the authors note that Japanese firms are integrated horizontally and vertically, and almost all of them are high-volume producers, compared with many American manufacturers that tend to focus on specialty chips alone. Capital costs are considerably lower for Japanese competitors, although access to capital has not been a concern for U.S. firms, the panel notes. Finally, profit margins are far lower for Japanese producers than American firms consider acceptable. The DSB study attributes this country's loss of leadership to the impact of such factors as lower productivity, demands for higher wages, poor quality control, insufficient numbers of technically trained workers and the traditional adversary relationship among business, labor, government and academia.

The DSB proposes government support -- to the tune of about $200 million annually -- for a Semiconductor Manufacturing Technology Institute to help offset present trends. The institute would develop, demonstrate and advance the technology for efficient, high-yield manufacturing of advanced semiconductor devices. The center is not envisioned as a government-sponsored production facility, although it would have limited capacity to provide for selected Department of Defense needs. Rather, it is anticipated that the institute -- in cooperation with business, government and academia -- will provide an influx of expertise to the sagging semiconductor industrial base; the study recommends the 64-megabit DRAM (dynamic random access memory) as an appropriate first effort. In addition, the authors call for expanded research and development funding in semiconductors, higher discretionary funds for DOD to "underpin healthy industrial research and development," and the establishment of eight centers at selected universities to improve semiconductor design and manufacturing techniques in the private sector.

Trade and Payments Data
(in millions of dollars unless otherwise indicated)

	1984	1985	January-December 1985	January-December 1986	October 1986	November 1986	December 1986
Japan's Balance of Payments							
Trade Balance	$44,257	$55,986	$55,986	$92,659*	$8,719*	$8,504*	$10,169*
Exports (f.o.b.)	168,290	174,015	174,015	205,558*	18,865*	16,590*	19,161*
Imports (f.o.b.)	124,033	118,029	118,029	112,899*	10,146*	8,086*	8,992*
Current Account Balance	35,003	49,169	49,169	85,966*	8,283*	8,144*	9,359*
Long-Term Capital (net)	-49,651	-64,542	-64,542	-131,814*	-16,348*	-13,780*	15,404*
Overall Balance	-15,200	-12,318	-12,318	-44,767	-8,081	-9,333	-7,058
International Reserves (end of period)	26,313	26,510	26,510	42,239	41,676	41,676	42,239
Japan's Customs Clearance Trade							
Trade Balance	33,611	46,099	46,099	82,666*	7,789	7,402	8,699*
Exports (f.o.b.)	170,114	175,638	175,638	209,164*	19,149	16,912	19,619*
Cars	21,899	25,402	25,402	32,955*	2,952	2,879	2,690*
Steel	13,852	13,566	13,566	12,706*	1,043	936	1,278*
Imports (c.i.f.)	136,503	129,539	129,539	126,498*	11,360	9,510	10,920*
Crude Oil	39,379	34,599	34,599	19,502*	1,235	1,255	1,443*
Japan-U.S. Trade							
Trade Balance	33,075	39,485	39,485	51,478*	4,999	4,894	4,739*
Exports (f.o.b.)	59,937	65,278	65,278	80,462*	7,507	6,893	7,152*
Imports (c.i.f.)	26,862	25,793	25,793	28,984*	2,509	1,998	2,413*
U.S.-Japan Trade							
Trade Balance (f.a.s./c.i.f.)	-36,796	-49,749	-49,749	-58,575	-4,982	-6,741	-3,825
Exports (f.a.s.)	23,575	22,631	22,631	26,882	2,286	1,990	2,305
Imports (c.i.f.)	60,371	72,380	72,380	85,457	7,268	8,731	6,130
Trade Balance (f.a.s./Customs)	-33,560	-46,152	-46,152	-55,030	-4,710	-6,402	-3,578
Exports (f.a.s.)	23,575	22,631	22,631	26,882	2,286	1,990	2,305
Industrial Supplies	9,139	8,680	8,680	8,752	835	759	878
Capital Goods	5,627	5,939	5,939	7,709	664	498	1,731
Food and Feed	5,929	5,001	5,001	5,043	458	441	390
Consumer Goods	1,476	1,416	1,416	1,690	164	155	131
Imports (Customs)	57,135	68,783	68,783	81,911	6,996	8,392	5,883
Automotive Products	18,477	24,980	24,980	32,849	2,826	3,464	2,443
Capital Goods	19,290	21,516	21,516	25,134	2,165	2,539	1,889
Consumer Goods	11,266	14,017	14,017	15,451	1,394	1,632	967
Industrial Supplies	7,276	7,035	7,035	6,949	502	637	470

*Preliminary

Japanese Economic Indicators

(percentage change from year-earlier period unless otherwise indicated)

	1984	1985	January-December 1985	January-December 1986	October 1986	November 1986	December 1986
Discount Rate (end of period)	5.0%	5.0%	5.0%	3.0%	3.5%	3.0%	3.0%
Outstanding Money Supply	7.8%	8.4%	8.4%	8.7%	8.5%	8.3%	8.2%
Industrial Production	11.1%	4.6%	4.6%	-0.3%	-1.0%	-2.3%	1.0%
Manufacturing Operating Rate	7.3%	1.2%	1.2%	-4.8%	-6.8%	-7.3%	-4.1%
Number of Bankruptcies	8.8%	-9.7%	-9.7%	-7.1%	-6.9%	-6.9%	-7.2%
Residential Construction Starts	4.4%	4.1%	4.1%	10.4%	14.9%	17.8%	12.9%
Job Openings to Applications (ratio)	0.65	0.68	0.68	0.62	0.61	0.61	0.62
Nominal Wages	4.3%	3.6%	3.6%	3.6%*	2.3%	4.2%	2.6%*
Labor Productivity	9.9%	4.2%	5.2%**	2.0%**	n.a.	n.a.	n.a.
Wholesale Prices	-0.3%	-1.1%	-1.1%	-9.3%	-11.3%	-10.2%	-9.9%
Consumer Prices	2.3%	2.0%	2.0%	0.6%	-0.3%	0.0%	-0.3%
Yen-Based Export Prices	0.6%	-1.4%	-1.4%	-14.5%	-12.8%	-8.5%	-7.7%
Yen-Based Import Prices	-3.4%	-2.5%	-2.5%	-34.7%	-39.0%	-35.5%	-34.4%

*Preliminary.
**Through September of each year only.

For Japan's most recent GNP figures, see JEI Report No. 46B, December 19, 1986.